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No. 99

In the Supreme Court of the United States.

OCTOBER TERM, 1928

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GUY C. EARL

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

U.S. GOVERNMENT PRINTING OFFICE: 1929

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Attorney General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Ninth Circuit, entered in the above cause on February 25, 1929, reversing a decision of the United States Board of Tax Appeals.

STATEMENT

This case reached the Circuit Court of Appeals on the petition of the respondent, Guy C. Earl, for a review of the decision of the Board of Tax Ap-

peals, determining an additional tax upon respondent's income for the years 1920 and 1921. The sole question in the case is whether a written agreement, between respondent and his wife, providing that the property which either of them owned, and which either of them might thereafter receive or acquire, was to be received, held, and owned by them as joint tenants, had the effect of making one-half of the salary and fees, earned and received by the respondent, taxable to his wife, or whether the salary and fees were community income, taxable, as such, all to the respondent.

The findings of fact made by the Board of Tax Appeals (R. 14–15) disclose that the respondent is, and was during the years 1920 and 1921, an attorney, resident in California. In 1888, respondent married. Having accumulated considerable property, consisting of cash, bonds, lands, and other property, and his wife, Ella F. Earl, having, at that time, about $30,000 worth of property, respondent, on June 1, 1901, entered into a contract in writing with his wife, as follows:

> It is agreed and understood between us that any property either of us now has or may hereafter receive or acquire (of any and every kind) in any way, either by earnings (including salaries, fees, etc.) or any rights by contract or otherwise during the existence of our marriage, or which we or either of us may receive by gift, bequest, devise or inheritance, and all the proceeds, issues and

profits of any and all such property shall be treated and considered and hereby is declared to be received, held, taken and owned by us as joint tenants and not otherwise with the right of survivorship.

(Signed) GUY C. EARL.
ELLA F. EARL.

The above agreement has been in effect since the date thereof, and all amounts received by the respondent, as income, from personal services, consisting of salaries, fees, etc., as well as the income from property, have been deposited in a joint bank account, which was opened at approximately the same time as the signing of the above agreement.

Respondent's salary, as an officer of the Great Western Power Company, and fees received, as an attorney, were deposited to their joint account immediately upon receipt thereof. Mrs. Earl, at all times, has had the right to draw against this account at will.

In the year 1920, respondent received as salary, fees, etc., the sum of $24,839, and in the year 1921, he received from the same sources $22,946.20. Respondent included only one-half of the above amounts as taxable income in the returns filed by him for those years. The Commissioner of Internal Revenue, in reviewing the respondent's returns, determined that the entire amount of said salary and fees earned by Earl was taxable to him and should have been included by him in gross income for the years 1920 and 1921. As a result, he pro-

posed an additional assessment upon respondent in the sum of $2,420.12 for the year 1920, and $2,432.46 for the year 1921. (R. 10.) The taxpayer, on October 7, 1925, prior to the enactment of the Revenue Act of 1926, took an appeal to the Board of Tax Appeals, which rendered its decision February 16, 1928, upholding the determination of the Commissioner. From this decision of the Board of Tax Appeals the respondent, on August 2, 1928, took an appeal to the Circuit Court of Appeals for the Ninth Circuit, which, on February 25, 1929, reversed the decision of the Board of Tax Appeals, holding that the contract was valid and such as a husband and wife may legally make; that under its provisions the personal earnings of respondent immediately became the joint property of himself and his wife as soon as earned, and that, as such, the said earnings were taxable one-half to each. (R. 38–40.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

I. In reversing the decision of the Board of Tax Appeals.

II. In holding that under the agreement between the respondent and his wife the personal earnings of the respondent became the joint property of him and his wife as soon as earned and became taxable one-half to each.

III. In not holding that the personal earnings of the respondent were taxable in their entirety to him.

REASONS FOR GRANTING THE WRIT

This case is of general importance. The principle involved is one which is constantly arising in various forms.

If the principle announced by the Circuit Court of Appeals becomes the settled law, then compensation for personal services may be divided into infinitesimal parts by agreements between any person having income from personal services and his immediate family so as to defeat the manifest intent of Congress to tax such income as a whole. Further, the principle announced seems broad enough to enable a person to escape taxation by mere assignments to third parties which operate to divest him of the right to receive his earnings.

If a husband, contracting with his wife, in the same manner and to the same extent as they could contract if unmarried, may assign to his wife a portion of his salary and fees and either have so much thereof paid directly to her, or receive and hold all of the salary and fees for himself and his wife, as joint tenants, with the result that he is taxable on a part only, his wife being taxable on the aliquot part so assigned to her, the doctrine of constructive receipt, long followed by the Bureau of Internal Revenue, and recognized by the Circuit Courts of Appeals in *Anderson* v. *Morris & E. R. Co.*, 216 Fed. 83; *West End St. Ry. Co.* v. *Malley*, 246 Fed. 625 (certiorari denied, 246 U. S. 671); *Rensselaer & S. R. Co.* v. *Irwin*, 249 Fed. 726 (certiorari denied,

246 U. S. 671); *Northern R. Co. of New Jersey* v. *Lowe,* 250 Fed. 856; *American Telegraph & Cable Co.* v. *United States,* 61 Ct. Cls. 326 (certiorari denied, 271 U. S. 660); *Houston Belt & Terminal Ry. Co.* v. *United States,* 250 Fed. 1; *Mitchell* v. *Bowers,* 9 F. (2d) 414, 15 F. (2d) 287 (certiorari denied, 273 U. S. 759); *United States* v. *Western Union Telegraph Co.,* 19 F. (2d) 157; and *Bing* v. *Bowers,* 22 F. (2d) 450, must be modified accordingly.

The decision below is in conflict with the rule generally recognized by the courts and relied upon by the Bureau of Internal Revenue, that an assign ment of future salary, fees, and wages, not yet contracted for, does not operate to pass anything *in praesenti,* but gives the assignee only a right enforceable in equity. The agreement providing for the creation of a joint tenancy in personal property not in existence and not yet contracted for can not give the wife any greater rights thereunder than if she were a mere assignee. *Cox* v. *Hughes,* 10 Cal. App. 553.

The decision, if acquiesced in, will result in confusion in the administration of the Revenue Acts.

WILLIAM D. MITCHELL,
Attorney General.

MAY, 1929.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the United States Circuit Court of Appeals (R. 38–40) is reported in 30 F. (2d) 898.

The opinion of the United States Board of Tax Appeals (R. 15–17) is reported in 10 B. T. A. 723.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered February 25, 1929. (R. 40.) The jurisdiction of this Court rests on the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925. The appeal to the Board of Tax Appeals was taken prior to the passage of the Revenue Act of 1926, and the decision of the Board was rendered subsequent to the passage of that Act, so that there is present in this case the question whether the statutes authorizing appeals from the Board of Tax Appeals to the United States Circuit Courts of Appeals are constitutional. This question is involved in *Old Colony Trust Company* v. *Commissioner of Internal Revenue,* No. 130, now being considered by this Court, but not yet decided.

QUESTION PRESENTED

A written agreement, entered into in 1901, between respondent and his wife, provided that the property which either of them owned, and which either of them might thereafter receive or acquire, was to be received, held, and owned by them as joint tenants. The sole question is, did this agreement have the effect of making one-half of the salary and fees earned and received by the respondent, in 1920 and 1921, taxable to his wife, or did the salary and

fees constitute income taxable as an entirety to the respondent?

STATUTES INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057:

PART II.—INDIVIDUALS

NORMAL TAX

SEC. 210. That, * * * there shall be levied, collected, and paid for each taxable year upon the *net income* of every individual a normal tax. * * * (Italics supplied.)

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions * * *.

SURTAX

SEC. 211. (a) That, * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.

Sections 210, 211 (a), 212 (a), and 213 of the Revenue Act of 1921, c. 136, 42 Stat. 227, are similar to the provisions of the 1918 Act above quoted.

STATEMENT

A statement of the facts and of the errors relied on will be found in the petition.

ARGUMENT

The question presented is one deserving the consideration of this Court on certiorari. Sections 210 and 211 (a) of the Revenue Acts of 1918 and 1921 impose a normal tax and a surtax upon the net income of every individual. Congress has also declared by Section 213 (a) of these Acts that the income derived as compensation for personal services shall be reported by the recipient and subjected to a Federal tax graduated in proportion to its extent. A personal exemption is granted each taxpayer, and the later statutes further provide for a credit in favor of earned income.

We think it is obvious that Congress intended that each individual should bear the tax burden in proportion to his ability to pay, to be measured by the amount of income realized from his personal efforts added to his other income. The principal question presented by this petition is whether the express purpose of Congress may be evaded by an agreement made by a taxpayer sharing his compensation for personal services with another, with the result that instead of paying a tax which reflects his comparative ability to pay, his compensation is so divided that he pays the tax which would have been due if his compensation had been one-half of what it actually was.

The decision of the court below is not restricted in its application to community property states. Neither is it restricted to husband and wife. It is a decision of general application. If by agreement between husband and wife, contracting as strangers, in a community property state, a wife can acquire an ownership in the husband's earnings, before they attain the community status, a similar agreement in states not having the community property law, but where a husband and wife may enter into valid contracts, would, under the decision below, enable a wife to acquire an ownership in a husband's earnings, from salary and fees, before they become his income. If this agreement operates *eo instanti* to vest title in the wife to one-half of the husband's earnings, as soon as earned, as held by the Circuit Court of Appeals, and prevents them from becoming the sole income of the earner, and prevents the Government tax from attaching, then it would seem that any valid assignment of the right to receive salary which has been earned would operate to make the salary of the earner the income of his assignee. It would thus be possible for any person to split up his salary by making various assignments so that all surtaxes could be avoided, and possibly all taxation. At least, the income would undoubtedly be thrown into the lower normal and surtax brackets, so that the provisions of the taxing acts would be to such an extent nullified. Likewise compensation for personal services might be divided by agreements between any person having income from

personal services and his immediate family so as to defeat the manifest intent of Congress to tax such income as a whole. The dependents for whose support Congress has allowed the taxpayer credits, might easily be invested with income derived from his personal services by the simple expedient of creating a joint tenancy to receive the income.

We think the decisions of this Court furnish precedents which indicate that the expressed will of Congress may not thus be circumvented. The recent decision in *Taft* v. *Bowers,* No. 16, October Term, 1928, decided February 18, 1929, shows that Congress may effectively deal with attempts to defeat the purpose to take part of all gain derived from capital investments. In that case the Court considered a Federal statute taxing property acquired by gift and held the donee upon sale of the property accountable for the entire gain measured by the cost to the donor. It was there recognized that by a mere gift of property to another and a subsequent sale thereof, the sovereign could not be deprived of the right to take by taxation a part of the entire gain, as defined by the Revenue Acts, derived from such sale.

In *Von Baumbach* v. *Sargent Land Co.,* 242 U. S. 503, the question was whether payments made under Minnesota mining leases constituted taxable income. The Minnesota rule of property recognized mining leases as actual leases and not the equivalent of deeds and it was urged upon this Court that the

local rule was decisive. This Court held that ordinarily and between private parties there is no question of the duty of the Federal court to follow a State rule of property and the impression left by the opinion is that when a Federal statute is involved, the Federal courts are free to determine such questions independently of the local rule. Such was the conclusion of the United States District Court for the Eastern District of Pennsylvania in *Rosenberger* v. *McCaughn,* 20 F. (2d) 139, affirmed 25 F. (2d) 699, certiorari denied October 8, 1928. See also *Weiss* v. *Wiener,* and *Routzahn* v. *Wiener,* Nos. 482, 483, October Term, 1928, decided April 22, 1929.

In *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110, an organization, recognized locally as a partnership, was treated as a corporation when applying a Federal revenue statute.

In *United States* v. *Robbins,* 269 U. S. 315, this Court said that even if a wife has an interest in community income, it does not follow that Congress can not tax the husband for the whole.

Of course, Congress may not ignore the fact that a piece of property is owned by more than one individual and tax the entire gain upon its sale to one of the owners alone. But we think that Congress may properly regard compensation for personal services as the sole income of the individual who performed the services and leave him to divide it after its receipt in any manner he thinks best.

Congress may not prevent its being *held* in joint tenancy, but, on the other hand, Congress may require that in applying a Federal revenue statute, it shall be treated as an entirety and taxed as the income of the individual who earned it.

So in this case, we urge that the purpose of Congress to tax as an entirety the compensation of an individual from personal services rendered by him, may not be thwarted by any agreement which attempts to convert the fruits of the efforts of a single individual into compensation for two individuals.

The decision of the Circuit Court of Appeals also disregards the established doctrine of constructive receipt heretofore applied and recognized in the administration of the Federal taxing statutes. The Bureau of Internal Revenue has long followed the practice of imposing an income tax on the earner of salary and wages, regardless of any agreement with a third party, whereby a part thereof should be paid directly to said third party.

Even if it be conceded that an assignee's interest vests *eo instanti* in salaries, when the same are earned, and that such assignee is entitled to receive the same direct, this fact is not determinative of the question here. The fact that a taxpayer did not, and was not entitled to, receive the salary which he earned, because of an agreement with a third person, would not make the salary any the less income to him and taxable to him. Such a situation is no different in principle from that arising when salary

is taken on an attachment proceeding. Nor does it differ in principle from an assignment of salary to take care of payments due on the purchase price of property, such as an automobile. In each of these cases, although part or all of the salary has not been actually received by the person earning it, it is none the less income taxable to him, in the contemplation of the law.

The Circuit Courts of Appeals have held, so that until this decision it appeared to be definitely settled, that income produced by investment or earned, although by agreement paid over to others, is nevertheless to be regarded as income of the earner or the owner of the property, for taxing purposes, upon the theory that the income has been constructively received. *Rensselaer & S. R. Co.* v. *Irwin,* 249 Fed. 726 (certiorari denied, 246 U. S. 671); *Anderson* v. *Morris & E. R. Co.,* 216 Fed. 83; *West End St. Ry. Co.* v. *Malley,* 246 Fed. 625 (certiorari denied, 246 U. S. 671); *Northern R. Co. of New Jersey* v. *Lowe,* 250 Fed. 856; *American Telegraph & Cable Co.* v. *United States,* 61 Ct. Cls. 326 (certiorari denied, 271 U. S. 660); *United States* v. *Western Union Telegraph Co.,* 19 F. (2d) 157; *Houston Belt & Terminal Ry. Co.* v. *United States,* 250 Fed. 1.

The same result was reached in the case of *Mitchell* v. *Bowers,* 9 F. (2d) 414, 15 F. (2d) 287 (certiorari denied, 273 U. S. 759). See also *Bing* v. *Bowers,* 22 F. (2d) 450.

The instant case is readily distinguishable from the cases in which it has been held that husband and wife may make a valid agreement, whereby the community relinquishes the right to income, in favor of that member of the community earning income. The most that can be said of these cases is that they recognize the right of a husband and wife to nullify the effect of the community property law with reference to their respective earnings which, except for that law, would have been their separate income and property. The effect given the present agreement by the decision of the Circuit Court of Appeals operates not only to nullify the provisions of the community property law but also the expressed intent of Congress to tax compensation from personal earnings as an entirety, and creates the anomalous situation of converting for tax purposes the personal earnings and income of respondent into the separate income of his wife.

Further, in the instant case respondent and his wife, contracting in a State which gives them no greater freedom of contract than if they were unmarried, seek to assign one to the other one-half of their future income, which income, in so far as the earnings of respondent here involved, was to be derived from a contract of employment not in existence at the time of the agreement. The case then becomes governed by the decisions respecting assignments of salary and fees to be earned in the

future, which at the time of the assignment were not contracted for.

The courts have held without exception that the assignment of future wages, not based on an existing contract, does not operate to pass a legal title thereto *in praesenti*. This is in accord with the laws of California which provide that a mere possibility not coupled with an interest can not be transferred. In that state, mere possibilities or expectancies not coupled with an interest are assignable only in equity, and equity will enforce the assignment only when the possibility or expectancy has changed into a vested interest or possession. *Cox* v. *Hughes,* 10 Cal. App. 553; *Walker* v. *Rich,* 79 Cal. App. 139. To the same effect are: *Matter of Black,* 138 App. Div. (N. Y.) 562; *Field* v. *Mayor,* etc., 6 N. Y. 179; *Cooper* v. *Douglass,* 44 Barbour (N. Y.) 409; *Herbert* v. *Bronson,* 125 Mass. 475; *Eagan* v. *Luby,* 133 Mass. 543; *Citizens Loan Assoc.* v. *Boston & Maine R. R.,* 196 Mass., 528. See also 2 Am. Eng. Ency. of Law, p. 1032; Story's Equity Jurisprudence (13th Ed.), Sec. 1040. It is, therefore, believed that under the present agreement the interest which the wife acquired in respondent's earnings was subordinate to the Government's claim for taxes.

CONCLUSION

While we believe that the court below has erred in construing the particular agreement involved in this case, it is urged that the Court should now

determine whether the express purpose of Congress to tax compensation for personal services as an entirety may be nullified by the mere act of the parties.

Respectfully submitted.

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MAY, 1929.

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